Energy is a Risky Business

(PRWEB) August 15, 2005 -- Energy trading is not for amateurs who think that they just bring over forex traders for a swing at the fences and get those great returns. Well, get real folks, some experienced but lesser talented hedge fund managers have blown up. Some big losses at investment banks in oil trading recently are also showing that energy risk is real, deep, complex and getting substantially more risky.

The often quoted remark that “traditional market theory would say that greater liquidity and thus less volatility” is just not true. I have had a continuing debate on 3 continents with economists who look for mean reversion and less volatility due to greater liquidity arguments. Let me say it straight one more time. It is different this time. When heating oil spreads go over gasoline this summer, it is different. When natural gas volatility goes down to 20% this spring, it is different. The old models and templates of energy trading are wrong. This is truly a new time with the rapid financialization of energy commodity markets with multinational oil, investment banks and hedge funds creating “the triangle of trading.”

The mechanistic trading that I have seen at some hedge funds prove it. They don’t get the returns. Volatility is rising because risk is endemic in the energy patch and there are more risks than ever before. The fact also is that energy markets are a long way from financial maturity and natural gas have now just gotten back to gas market liquidity pre Enron’s demise in December 2001.

When the death of Enchanted Rock, a $200 million fund, mentions these new factors, other hedge fund managers ought to listen to the truth of that very brave manager who told it like it is and returned money to investors. Things are risky out there.

The fact is if you are going to play in the big leagues you better be prepared for down markets, volatility, weather factors, supply/demand factors, geopolitical risk like you have never seen before, transportation and supply logistics that are complex not to mention the continued globalization of the international energy business. You also need unprecedented access to information flow. Risk management in this emerging environment of speed funds, more volatility and risk is not for the faint hearted and the dumb. It means use of knowledge, experience and a contrarian streak that simply can not be taught. It is learned by doing. This is a wake up call for many hedge funds to the many risks of the energy complex. The rewards are only there for the smart and disciplined. Welcome to the Energy Club.

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